

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 7050

BILL NUMBER: HB 1541

NOTE PREPARED: Jan 23, 2013

BILL AMENDED:

SUBJECT: Various Tax Matters.

FIRST AUTHOR: Rep. Turner

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill repeals the automatic taxpayer refund. It decreases the Individual Adjusted Gross Income (AGI) Tax rate from 3.40% to 3.06% over three years. The phase down of the tax rate begins in tax year 2014.

The bill provides that the Inheritance Tax does not apply to property interests transferred by decedents whose deaths occur after December 31, 2017. It specifies that certain definitions apply after the elimination of the Inheritance Tax for purposes of the Indiana Estate Tax and the Indiana Generation-Skipping Transfer Tax. It provides that the Inheritance Tax replacement amount is calculated in the same manner that it was calculated between 1997 and 2012. (Current law provides that a county is not eligible for a replacement amount unless it receives a replacement amount for Inheritance Tax collections in state fiscal year 2011-2012.) The bill also phases out Inheritance Tax replacement amount distributions from 2013 to 2017.

Effective Date: July 1, 2013.

Summary of NET State Impact: The estimated annual net fiscal impact to the state General Fund due to the bill from FY 2014 to FY 2017 is reported is summarized below.

Fiscal Year	Income Tax Rate Cut (in Mil)	Inheritance Tax Changes (in Mil)	Inheritance Tax Replacement Payments (in Mil)	Net Increase (Decrease) (in Mil)
FY 2014	(\$103.0)	-	(\$0.02)	(\$103.2)
FY 2015	(\$286.4)	(\$6.6 - \$6.9)	(\$.13)	(\$293.1 M - \$293.4 M)
FY 2016	(\$439.6)	(\$19.9 - \$20.7)	(\$.26)	(\$459.8 M - \$460.6 M)
FY 2017	(\$526.5)	(\$33.2 - \$34.5)	(\$.42)	(\$560.1 M - \$561.4 M)

Explanation of State Expenditures: *Automatic Taxpayer Refund:* The bill makes changes to the current law as it relates to the use of excess state reserves. Under current law, after the end of each odd-numbered state fiscal year, the Office of Management and Budget (OMB) is required to establish the amount of excess reserves. Current law requires excess reserves above a threshold to be distributed to certain pension funds and to provide the automatic tax payer refund. The State Budget Agency estimates that \$721.2 M in total excess reserves will be distributed to certain pension funds and taxpayer refunds in FY 2013. Under current law the next calculation and potential distributions of excess reserves will occur in FY 2014. Effective July 1, 2013, the bill removes the requirement that the excess reserves be used for the purposes of providing an automatic taxpayer refund. The potential for an automatic taxpayer refund under current statute in FY 2014 or subsequent years is indeterminable and depends on future revenues and future appropriations made by the General Assembly.

Background: Automatic Taxpayer Refund: P.L 229-2011 set statutory distributions if the state reserves at the end of the fiscal year were in excess of the thresholds established by the Act. It provided for: (1) additional contributions to be made to the Pension Stabilization Fund and (2) nonrefundable tax credits to be paid to eligible Individual AGI Tax filers. P.L 160-2012 changed the threshold for use of excess reserves to 12.5% of general fund appropriations for the state fiscal year (rather than 10%, under P.L 229-2011). It specified that: (1) if the amount of the excess reserves, including any carryover amounts, are less than \$50 M, the excess reserves shall be carried over to the next year; and (2) if the excess reserves are \$50 M or more, 50% of the excess reserves shall be transferred to certain pension funds and 50% of the excess reserves shall be used for the purposes of providing an automatic taxpayer refund. It provided that beginning in 2013, the OMB shall calculate the excess reserves, after the end of each odd-numbered state fiscal years (not every year as in P.L 2009-20011). This bill removes the automatic tax payer refund and changes the references from Governor to OMB for the purpose of laws related to use of excess reserves.

Department of State Revenue (DOR): The Department of State Revenue will incur additional expenses to revise tax forms, instructions, computer programs, and withholding tables to reflect the changes made by the bill. The DOR's current level of resources should be sufficient to implement these changes.

Also, there could be a savings to the state from a reduction in staff of the Inheritance Tax Section of the Department of State Revenue. The December 3, 2012, state staffing table indicates that the Inheritance Tax Division has 7 full-time employees with an annual salary of about \$268,000. Current law provides for a phase out of the Inheritance Tax by CY 2022, which could also result in savings from a reduction in staff over time.

County Inheritance Tax Replacement Payments: This bill changes the calculation of Inheritance Tax replacement payments to counties which would result in an increase in expenditures from the state General Fund from FY 2014 until FY 2019 when replacement payments are eliminated by this bill. See *Explanation*

of Local Revenues for more information.

Explanation of State Revenues: Income Tax Rate Cut: This provision in the bill will result in a revenue loss to the state General Fund. The revenue loss from the rate reduction is estimated to begin in FY 2014 and is outlined in the table below.

Fiscal Year	State General Fund Impact (In Millions)	Percent Reduction in Tax Revenues
2014	-\$103.0	-2.1%
2015	-\$286.4	-5.5%
2016	-\$439.6	-8.1%
2017	-\$526.5	-9.4%

The analysis assumes that individual income tax filers will change their quarterly estimated payments and income tax withholding payments based on the reduced tax rates. These adjustments will occur starting January 1, 2014, for tax year 2014, and at the beginning of two subsequent tax years. The full impact of the rate phase down would occur in FY 2017 and thereafter.

Under current law, Indiana imposes a flat income tax rate of 3.4% on adjusted gross income (AGI) of individual income taxpayers. The Individual AGI Tax rate reduction would be phased in as specified in the table below.

Tax Year	Current Rate	Proposed Rate	Percentage Point Change from Current Rate	Percent Change from Current Rate
2013	3.40%	3.40%	0.00%	0.00%
2014	3.40%	3.25%	-0.15%	-4.41%
2015	3.40%	3.15%	-0.25%	-7.35%
2016 and thereafter	3.40%	3.06%	-0.34%	-10.00%

Since the fiscal year begins on July 1, any change in the tax rate beginning January 1 will lead to the fiscal year having two different tax rates. The average of the two different tax rates occurring in FY 2014, FY 2015 and FY 2016 was calculated and used to estimate the revenue loss in those years. FY 2017 would be the first year of the full impact of the tax rate cut to 3.06%. The Revenue Technical Committee forecast (December 17, 2012) forecasted individual income tax revenue of \$5,011.6 M in FY 2014 and \$5,213.1 M in FY 2015. Income tax revenues for FY 2016 and FY 2017 were estimated using FY 2015 as the base year and applying the historical compound average annual growth rate. Results from empirical literature on taxable income elasticity along with the proposed decrement in tax rate were used to calculate the impact of the rate change on taxable income for each fiscal year. The fiscal impact will continue to result in an estimated revenue loss of 9.4% of the income tax collections at the current tax rate in years thereafter. 100% of the state individual income tax is deposited in the state General Fund.

Inheritance Tax: This bill would accelerate the phase out of the Inheritance Tax by increasing current law credit percentages beginning with decedents who die in 2014 and eliminating the tax altogether for decedents

who die beginning in CY 2018. Current law provides that the Inheritance Tax is eliminated for decedents who die beginning in CY 2022. The following table provides the estimated state revenue loss attributable to this bill.

Fiscal Year Impact	Estimated State Revenue Loss
FY 2015	(\$6.6 M - \$6.9 M)
FY 2016	(\$19.9 M - \$20.7 M)
FY 2017	(\$33.2 M - \$34.5 M)
FY 2018	(\$46.5 M - \$48.3 M)
FY 2019	(\$53.1 M - \$55.2 M)
FY 2020	(\$46.5 M - \$48.3 M)
FY 2021	(\$33.2 M - \$34.5 M)
FY 2022	(\$19.9 M - \$20.7 M)
FY 2023	(\$6.6 M - \$6.9 M)
FY 2024	\$0

SEA 293-12 provided for a phase out of the Inheritance Tax beginning with decedents whose deaths occur during CY 2013. The phase out is accomplished by providing a credit against the Inheritance Tax liability that increases from 2013 through 2022. The table below compares the credit percentages under current statute and under the bill.

Year of Decedent's Death	Current Credit Percentages	Proposed Credit Percentages
2013	10%	10%
2014	20%	30%
2015	30%	50%
2016	40%	70%
2017	50%	90%
2018	60%	100%
2019	70%	100%
2020	80%	100%
2021	90%	100%
2022	100%	100%

The Inheritance Tax will no longer apply to property interests transferred by decedents whose deaths occur after December 31, 2021, under current statute. The Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5% early discount).

Explanation of Local Expenditures:

Explanation of Local Revenues: *Inheritance Tax:* The acceleration of the phase out of the Inheritance Tax provided by this bill could result in an annual revenue loss to counties beginning in FY 2015. This bill would also increase the amount of replacement payments made to counties from the state General Fund beginning in FY 2014 due to the acceleration of the phase out of the Inheritance Tax and the change in the calculation of replacement payments. However, this bill provides that replacement payments will end by FY 2019 while current law phases out the replacement payments by FY 2024.

Fiscal Year Impact	Local Share of Inheritance Tax Revenue Loss	Estimated Net Increase (Decrease) of Replacement Payments	Net Increase (Decrease)
FY 2014	-	\$20,000	\$20,000
FY 2015	(\$0.5 M - \$0.6 M)	\$133,000	(\$0.4 M - \$0.5 M)
FY 2016	(\$1.7 M - \$1.8 M)	\$264,000	(\$1.4 M - \$1.5 M)
FY 2017	(\$2.9 M - \$3.0 M)	\$418,000	(\$2.4 M - \$2.6 M)
FY 2018	(\$4.0 M - \$4.2 M)	\$288,000	(\$3.7 M - \$3.9 M)
FY 2019	(\$4.6 M - \$4.8 M)	(\$18,000)	(\$4.6 M - \$4.8 M)
FY 2020	(\$4.0 M - \$4.2 M)	(\$15,000)	(\$4.0 M - \$4.2 M)
FY 2021	(\$2.9 M - \$3.0 M)	(\$11,000)	(\$2.9 M - \$3.0 M)
FY 2022	(\$1.7 M - 1.8 M)	(\$7,000)	(\$1.7 M - 1.8 M)
FY 2023	(\$0.5 M - \$0.6 M)	(\$4,000)	(\$0.5 M - \$0.6 M)
FY 2024	\$0	\$0	\$0

This bill changes the calculation of Inheritance Tax replacement payments made to counties beginning in FY 2014. The fiscal impact due to this change is summarized below.

Fiscal Year Impact	Estimated Replacement Payments Under Current Law	Estimated Replacement Payments Provided by this Bill	Net Increase (Decrease)
FY 2014	\$37,000	\$57,000	\$20,000
FY 2015	\$33,000	\$166,000	\$133,000
FY 2016	\$30,000	\$294,000	\$264,000
FY 2017	\$26,000	\$444,000	\$418,000
FY 2018	\$22,000	\$310,000	\$288,000
FY 2019	\$18,000	\$0	(\$18,000)
FY 2020	\$15,000	\$0	(\$15,000)
FY 2021	\$11,000	\$0	(\$11,000)
FY 2022	\$7,000	\$0	(\$7,000)
FY 2023	\$4,000	\$0	(\$4,000)
FY 2024	\$0	\$0	\$0

Background Information - This bill changes the calculation method that was in statute prior to SEA 293-2012, multiplied by percentages that phase out the payments by FY 2019. The calculation will be based upon the difference between the Inheritance Taxes retained by a county in a state fiscal year and the average amount collected between 1990 and 1997, excluding the highest year and lowest year, multiplied by the appropriate percentage. The current calculation is the Inheritance Tax replacement payment distributed to the county for FY 2012 multiplied by percentages that phase out the payments by FY 2023. The table below summarizes the phase out percentages in current statute and under the bill.

Fiscal Year of Distribution	County Replacement Payment Phase Out Under Current Law	County Replacement Payment Phase Out Under this Bill
FY 2014	91%	90%
FY 2015	82%	70%
FY 2016	73%	50%
FY 2017	64%	30%
FY 2018	55%	10%
FY 2019	45%	End of Replacement Payments
FY 2020	36%	
FY 2021	27%	
FY 2022	18%	
FY 2023	9%	
FY 2024	End of Replacement Payments	

State Agencies Affected: Department of State Revenue, Office of Management and Budget, Governor.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, December 17, 2012. OFMA Income Tax Database. Long, James E. "The Impact of Marginal Tax Rates on Taxable Income: Evidence from State Income Tax Differentials." Southern Economic Journal 65(4): 855. Bruce, Donald, John Deskins, and William Fox. (2005) On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning." Donald Bruce, John Deskins, and William Fox. (2006). "On The Relative Distortions of State Sales, Corporate Income and Personal Income Taxes." OFMA Inheritance Tax Database; Revenue Technical Committee, State Revenue Forecast, Fiscal Year 2015, December 17, 2012; Quarterly Inheritance Tax Reports, FY 1997- FY 2012.

Fiscal Analyst: Randhir Jha, 317-232-9556; Jessica Harmon, 317-232-9854.